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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Service

CC Docket No. 96-112

To: The Commission

DOCKET FILE COPY ORIGINAL

COMMENTS

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Dated: May 31, 1996

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SUMMARY

In the NPRM the Commission tentatively concludes that it should prescribe a fixed factor for allocating loop plant common costs between regulated and nonregulated activities, and proposes a fifty percent fixed allocator that would split the costs of loop plant equally between regulated and nonregulated activities.

Any cost allocation method adopted in this proceeding must be consistent with any action taken in CC Docket No. 96-98 with respect to the determination of the cost of unbundled network elements provided by LECs to competing carriers.

PRTC opposes both the general concept of using a fixed allocator for loop plant costs, and the specific proposal of using a fifty percent allocator for loop plant. The use of a fixed allocator is inappropriate at this time. The use of the telephone network for nonregulated services such as video programming is currently so rare that a fixed allocator of any proportion penalizes the vast majority of LECs that do not provide such services over their networks. Further, use of a fixed allocator of any significant proportion penalizes even those LECs that do provide such services but provide them only to a handful of subscribers.

The use of a fifty percent allocator in particular would be so unreasonable as to be confiscatory. At minimum it would provide a strong disincentive for a LEC to provide nonregulated

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services such as video programming over a hybrid network, and in fact would likely make the costs of providing such services economically prohibitive. Worse, it would leave a LEC that does not provide such services without any manner by which to recover half of its loop costs incurred in providing telephone service, thus endangering the LEC's economic viability.

If the Commission insists on adopting an allocator for loop plant in this proceeding, the allocator should be based on the relative revenue generated by the regulated versus the nonregulated activities. While not without its problems, such an allocator would better reflect the extent of a LEC's entry into the competitive nonregulated services marketplace than the Commission's proposed fifty percent fixed allocator.

Any allocator adopted in this proceeding must be applied only to loop plant that is actually used for nonregulated service. This would prevent the LEC from being required to allocated costs to nonregulated activities when there is no off-setting stream of revenue from nonregulated services.

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COMMENTS

Puerto Rico Telephone Company ("PRTC"), by its attorneys and pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, submits these Comments in response to the captioned Notice of Proposed Rulemaking ("NPRM") adopted and released on May 10, 1996.[1/]

I. INTRODUCTION

In this NPRM the Commission proposes to amend its cost allocation rules to accommodate an incumbent local exchange carrier's provision of telephone service and competitive nonregulated services over the same network facilities.[2/] While the title of the NPRM suggests that its focus is video programming services, paragraph 6 of the NPRM explains that it addresses "methods for allocating costs between regulated

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[1/] By Order released May 24, 1996 (DA 96-839), the Commission extended the deadline for filing comments from May 28, 1996 to May 31, 1996.

[2/] Such facilities are referred to as "hybrid" facilities or a "hybrid" network.

activities subject to Title II and nonregulated activities including video services and other offerings that become subject to competition . . . ." Thus, this NPRM addresses cost allocation procedures with respect to all nonregulated activities.

In the NPRM, the Commission observes that its rules for allocating costs between interstate and intrastate regulated services use fixed allocation factors. It recognizes that fixed factors have not generally been used in the Part 64 cost allocation process, but maintains that as high-capacity services become more widely used, fixed factors for allocating costs between regulated and nonregulated activities would simplify the allocation process by eliminating the need to measure usage. NPRM ¶¶ 37-38.

The Commission therefore tentatively concludes that it should prescribe a fixed factor for allocating loop plant common costs between regulated and nonregulated activities, and proposes a fifty percent fixed allocator that would split the costs of loop plant equally between regulated and nonregulated activities. NPRM ¶¶ 39-41.

Any cost allocation method the Commission adopts in this proceeding must be consistent with the formula for determining the costs of network elements provided by incumbent local exchange carriers ("LECs") to competing carriers under new Section 252(d) of the Act. Otherwise, LECs will be placed at a severe competitive disadvantage because their costs of providing service will be higher than the competing carriers' costs for providing the same service over the LECs' facilities.

PRTC opposes both the general concept of using a fixed allocator for loop plant costs, and the specific proposal of using a fifty percent allocator for loop plant. The use of a fixed allocator is inappropriate at this time. The use of the telephone network for nonregulated services such as video programming is currently so rare that a fixed allocator of any proportion penalizes the vast majority of LECS that do not provide such services over their networks. Further, use of a fixed allocator of any significant proportion penalizes even those LECs that do provide such services but provide them only to a handful of subscribers.

The use of a fifty percent allocator in particular would be so unreasonable as to be confiscatory. At minimum it would provide a strong disincentive for a LEC to provide nonregulated services such as video programming over a hybrid network, and in fact would likely make the costs of providing such services economically prohibitive. Worse, it would leave a LEC that does not provide such services without any manner by which to recover half of its loop costs incurred in providing telephone service, thus endangering the LEC's economic viability.

II. ANY COST ALLOCATION METHOD ADOPTED BY THE COMMISSION IN THIS PROCEEDING MUST BE CONSISTENT WITH THE COST DETERMINATION PRESCRIBED UNDER SECTION 252(d) OF THE ACT

Under the terms of the Telecommunications Act of 1996 creating new Section 252(d) of the Communications Act, LECs must provide network elements to competing carriers at a rate "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the . . . network element" and "may include a reasonable profit."

The Commission is currently conducting a proceeding to decide how the costs of network elements under Section 252(d) will be determined.[3/] Any method adopted by the Commission in this proceeding for allocating costs between regulated and nonregulated services must be consistent with the method for allocating costs to network elements prescribed in CC Docket No. 96-98. Otherwise, LECs could be placed at a severe competitive disadvantage with respect to services provided by competing carriers.

For example, consider the case where a LEC is required to provide loop access to a competing carrier at a price which does not fully reflect its costs due to the cost determination method prescribed in CC Docket No. 96-98, and that competing carrier provides video services over the loop. The LEC also uses the loop to provide video services, and, because of the cost allocation method adopted in this proceeding, must allocate more than its actual loop costs to that service. The competing carrier would be able to offer its video service to the end user at a lower price than the LEC is able to offer, because the LEC has more costs to recover simply as a result of two inconsistent

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[3/] See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, FCC 96-182 (rel. April 19, 1996).

cost allocation/determination methods prescribed by the Commission.

Thus, the Commission must ensure that any cost allocation method adopted in this proceeding is consistent with action taken in CC Docket No. 96-98.

III. THE USE OF A FIXED ALLOCATOR AT THIS TIME IS INAPPROPRIATE

The vast majority of LECs do not currently provide video programming or other competitive nonregulated services over their telephone networks, nor, given the economic drawbacks, are they likely to do so in the near future. Some LECs provide video services over stand-alone cable facilities, and some over "wireless" facilities, but neither of these implicate the Commission's cost allocation rules for joint and common costs of hybrid facilities. Those few LECs that do offer video programming service over hybrid facilities (i.e., video dialtone service) provide service to only a handful of subscribers. Thus, the vast majority of plant used to provide telephone service is currently used to provide only telephone service.

Nor is this situation likely to change in the near future. PRTC, for example, applied for and obtained authorization from the Commission for a video dialtone technical trial. The high cost of the technology required to upgrade PRTC's telephone network to conduct the trial, however, compelled PRTC to postpone its trial in order evaluate less costly alternatives. Although the cost for the technology needed to offer broadband video services over an upgraded telephone network will likely drop over time, it is unlikely that many LECs will be in the economic position to offer such services to a large portion of their subscribers for some time to come. And, since any video service offered by the LECs must compete with conventional cable systems, wireless cable systems, and DBS, LECs may be unlikely to enter the video market via such a costly method when these alternatives are available.

Even when LECs start offering competitive nonregulated services over hybrid facilities, they are likely to do so by means of widely divergent technologies and architectures, and at widely varying rates of deployment. That any fixed allocator prescribed under such circumstances would bear any resemblance to cost-causation for a particular LEC's facilities is highly unlikely.

Thus, the Commission should not take the arbitrary step of prescribing a fixed allocator that would automatically allocate a portion of a LEC's loop plant costs to nonregulated accounts regardless of whether, the extent to which, or the means by which, the company provides video or other nonregulated services over those facilities.

IV. A FIFTY PERCENT ALLOCATOR IS INSUPPORTABLE

The Commission proposes to prescribe a fixed allocator of fifty percent for loop plant, splitting the costs of the loop equally between regulated and nonregulated activities. NPRM ¶ 39. Such an over-allocation of costs to nonregulated activities, however, would be both confiscatory and counterproductive to the Commission's goals of a competitive video marketplace.

In proposing a fifty percent allocator, the Commission did not discuss its economic effect. According to the May 1995 Monitoring Report,[4] the total unseparated non-traffic sensitive revenue requirement (i.e., loop cost) for all LECs in 1993 was more than $36 billion representing 148 million loops nationwide.[5] A fifty percent fixed allocator applied to this $36 billion revenue requirement would result in the allocation to nonregulated activities of an average of $10 per month per telephone subscriber for each LEC. This is the average amount that LECs would not be permitted to recover through regulated services provided to carriers and end users.[6]

Under the Commission's proposal, LECs that do not provide nonregulated services using the loop plant would have no means of recovering that amount, because there would be no revenue stream from nonregulated services from which it could be recovered. Such a result would gravely endanger a LEC's economic viability,

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[4] "Monitoring Report, CC Docket No. 87-339, May 1995, Prepared by Federal and State Staff for the Federal-State Joint Board in CC Docket No. 80-286."

[5] Id. at 84, 85 (table 3.5 and table 3.6).

[6] High-cost LECs such as PRTC would lose much more than the average. In PRTC's case, roughly $30 per month per subscriber is the amount PRTC would not be permitted to recover from carriers or telephone subscribers. Since the provision of video service over the local loop is presently uneconomic, this would result in a monthly loss of $30 million.

and could result in unconstitutional confiscation of LEC property.

If a LEC did provide nonregulated services, it could attempt to recover the amount from subscribers to those services. Considering the infancy of such services, however, full, or even significant, recovery would be impossible. Subscribership to LEC nonregulated services provided over hybrid facilities is unlikely to approach significant numbers for years to come. Therefore, when the $10 per month per telephone subscriber revenue requirement must be borne by the handful of nonregulated service subscribers, the cost of subscribing to such service would become even more prohibitive.[7] Moreover, that monthly figure accounts only for the cost of the loop plant. It does not factor in the cost of the upgrades to the network that are necessary for providing such service, nor, in the case of video services, the cost of obtaining the video programming itself.

Such a high revenue requirement caused by the proposed fifty percent allocator would make it economically infeasible for LECs to provide competitive nonregulated services. This would deprive consumers of competition for such services, as well as depriving regulated ratepayers of the benefit of economies of scope associated with hybrid facilities.

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[7] For example, if a LEC has one million telephone subscribers, and provides some video service over a hybrid network, it must recover $10 million per month in loop costs from its video service subscribers. This means that even if there are 100,000 video subscribers, the LEC much charge each video subscriber $100 per month just to recover its loop costs.

The NPRM recognized that over-allocation of costs to nonregulated services would dissuade LECs from providing such services. NPRM ¶ 20. The proposed fifty percent allocator constitutes a drastic over-allocation, and should not be adopted.

V. IF THE COMMISSION INSISTS ON ADOPTING AN ALLOCATOR, IT SHOULD BE BASED ON RELATIVE REVENUES

If the Commission insists on adopting an allocator for loop plant in this proceeding, the allocator should be based on the relative revenue generated by the regulated versus the nonregulated activities. For example, if a LEC's nonregulated activities provided over hybrid facilities account for 25% of the revenue generated by those facilities, and regulated activities provided over those facilities account for the remaining 75% of the revenue generated, then 25% of the costs of the facilities should be allocated to nonregulated activities, and 75% allocated to regulated activities.[8]

Such an allocator would better reflect the extent of a LEC's entry into the competitive nonregulated services marketplace. If a LEC did not provide such services, then it would not be forced to allocate loop costs to such activities, thereby avoiding the creation of nonrecoverable costs. If a LEC provided a significant amount of nonregulated services, then a revenue-based allocator would ensure that a significant portion of LEC costs would be allocated to such services.

8/ The Commission currently uses revenue-based allocations in its separations procedures for costs such and marketing and business office activities. See 47 C.F.R. §§ 36.372(a) and 36.377(a)(2).

Even a relative revenue-based allocator could become problematic in time, as LECs became successful entrants into the nonregulated services marketplace. Under the terms of the Telecommunications Act of 1996, a competing provider could purchase the use of a local loop under new Sections 251 and 252 and, depending on the pricing formula ultimately adopted by the Commission, the price the LEC must charge the competitor for that loop may be lower than cost because the price did not include a reasonable allocation of overhead costs. In such a case, because the LEC's provision of the loop to the competitor is a regulated activity, the relative revenues generated by the LEC's regulated versus nonregulated activities would be skewed. The nonregulated services would account for an undue proportion of revenue because they would carry the remaining overhead.

While a relative revenue-based allocator thus could become a competitive disadvantage to LECs at the time when LECs are successful providers of nonregulated services, as an interim measure it does not have the flaws found in the Commission's proposed fifty percent fixed allocator. Thus, if the Commission adopts an allocator for loop costs in this proceeding, it should adopt, at least on an interim basis, a relative revenue-based allocator.

VI. IF ANY ALLOCATOR IS ADOPTED, IT SHOULD BE APPLIED ONLY TO LOOP PLANT ACTUALLY USED FOR NONREGULATED SERVICE

If the Commission adopts any allocator for loop plant in this proceeding, including the relative revenue-based allocator suggested by PRTC, the Commission must ensure that the allocator is applied without jeopardizing LEC cost recovery. If the LEC does not provide video or other significant nonregulated services via the local loop, then no part of its loop plant should be allocated to nonregulated activities. If the LEC does provide such services, then only that loop plant actually used for such service should be subject to the allocator.

Under this approach, as a LEC uses sections of loop plant to provide nonregulated services, that plant would be removed from the regulated category and become subject to the allocator. This ongoing process would prevent the LEC from being required to allocate costs to nonregulated activities when there is no off-setting stream of revenue from nonregulated services.

CONCLUSION

For these reasons, the Commission should not adopt a fixed allocator for loop plant costs as proposed in its NPRM. To the extent that any cost allocation method is adopted in this proceeding, it must be consistent with action taken in CC Docket No. 96-98.

Respectfully submitted,

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May 31, 1996

Certificate of Service

I hereby certify that a copy of the foregoing Comments of Puerto Rico Telephone Company was sent by hand on this 31st day of May, 1996, to the below-listed parties:

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